



## Finding a Smooth Path to Repatriate Cash and Profits from China

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# Key Contacts



## Hong Ye

Deloitte, Shanghai  
International and M&A  
Tax services

### Partner

Direct: +86 21 6141 1171  
Mobile: +86 135 8563 4153  
Email: hoye@deloitte.com.cn

- Hong has over 15 years of experience in legal and tax practice in China, Singapore and the US. She specializes in cross-border tax structuring and planning, M&A and private entity funds. She also advises on a wide range of tax matters relating to real estate investments, financial derivatives and various business transactions in China. She serves clients in a broad range of industries.
- Prior to joining Deloitte, Hong worked as an in-house counsel for a Fortune 100 US company in Singapore and the US and practiced law in China, advising on international transactions as well as general corporate and commercial legal matters.
- Hong published articles on Tax Notes International, CCH China Tax Intelligence, IBFD Asia-Pacific Tax Bulletin on various tax issues. She also represented Deloitte to speak at seminars on China inbound/outbound investments, M&A taxation and RMB fund topics.
- Hong is admitted to the bar organizations of both the State of New York and China. She received an LL.M. in Taxation from New York University School of Law, an LL.M. in Common Law Studies from Georgetown University Law Center and an LL.B. from Peking University School of Law.



## Wei Shu

Deloitte, Shanghai  
Transfer Pricing

### Partner

Direct: +86 21 6141 1036  
Mobile: +86 137 6128 3988  
Email: wshu@deloitte.com.cn

- Dr. Wei Shu is the lead economist of Deloitte Touche Tohmatsu's transfer pricing practice in China. With fifteen years of professional transfer pricing experience, he had worked in Washington DC, Los Angeles and the Silicon Valley before he joined the firm's Shanghai office in June 2002.
- Dr. Shu has assisted numerous multinational companies in various industries in both the US and China with transfer pricing contemporaneous documentation, tax authority transfer pricing audits, Advance Pricing Agreements and both compliance- and efficiency-driven transfer pricing/tax planning. His clients include large companies in high-tech, textile and clothing, automobile, electronics, chemicals, pharmaceuticals, luxury goods, business services, sports goods and food and beverages in addition to a number of very large contract manufacturers. He was the China team's chief economist on China's first bilateral Advance Pricing Agreement.
- As one of the best and most experienced Chinese speaking transfer pricing economists in the world, Dr. Shu is a frequent speaker on the Chinese transfer pricing issues and has published many articles in the BNA Transfer Pricing Report and other transfer pricing/international tax journals.
- Dr. Shu received his B.A. in economics from Fudan University in China and Ph.D. in economics (finance minor) from the University of Maryland at College Park in the US.

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# 1. Quick Overview of Cash Repatriation Strategies

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# Quick Overview of Cash Repatriation Strategies

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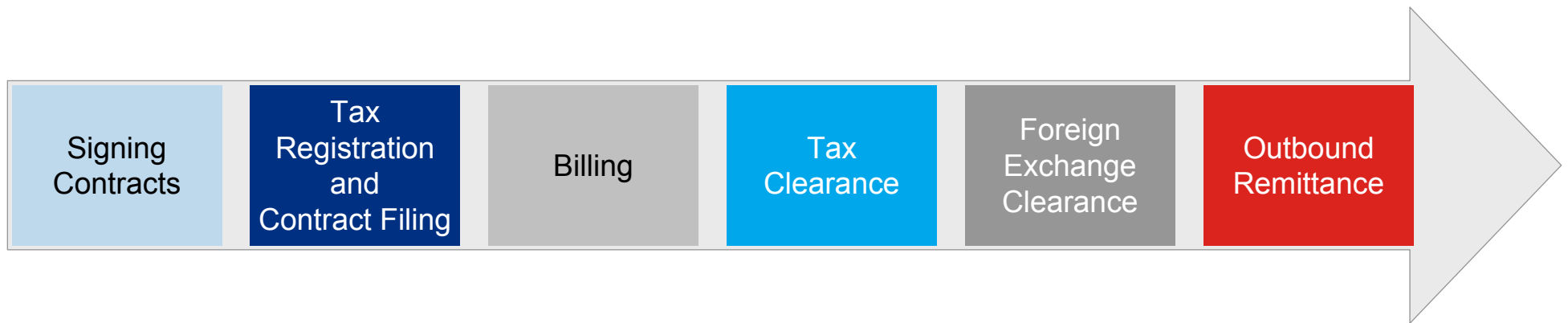
- Key considerations for formulating a profit/cash repatriation strategy include
  - Remittance requirement under Chinese foreign exchange control system
  - Chinese tax liabilities for the payee and deductibility of expenses for the payer
  - Timing of repatriation
- The most commonly used profit/cash repatriation strategies in China include
  - Dividend
  - Interest
  - Royalty
  - Service fee
  - Cost reimbursement and cost sharing, etc.

## 2. Overview of the Foreign Exchange Requirements and Tax Rules

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# General Remittance Procedures

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# FX Control Rule and Procedural Requirements

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Huifa [2008] No. 64

## Items Subject to the Submission of Tax Certificate

- In general, only prescribed types of trade payments and non-trade payments are allowed to be remitted out of China, provided that relevant approval, verification or filing requirements are properly fulfilled
- Scopes of payments
  - Service income from Chinese parties
  - Payroll compensation for working in China—received by overseas individual
  - Capital relevant items, i.e. dividends, profits, interests and guarantee fees, etc.
  - Non-capital items, i.e. donation, compensation, taxation and occasional income, etc.
  - Rental income from finance lease, income from transfer of immovable property, income from equity transfer, etc.
- Mandatory application for Tax Clearance/Exemption Certificates
  - Where a domestic institution/individual intends to make payment to overseas
  - For every single payment exceeding US\$30,000 equivalent
- Effective from January 1, 2009

# FX Control Rule and Procedural Requirements (Cont'd)

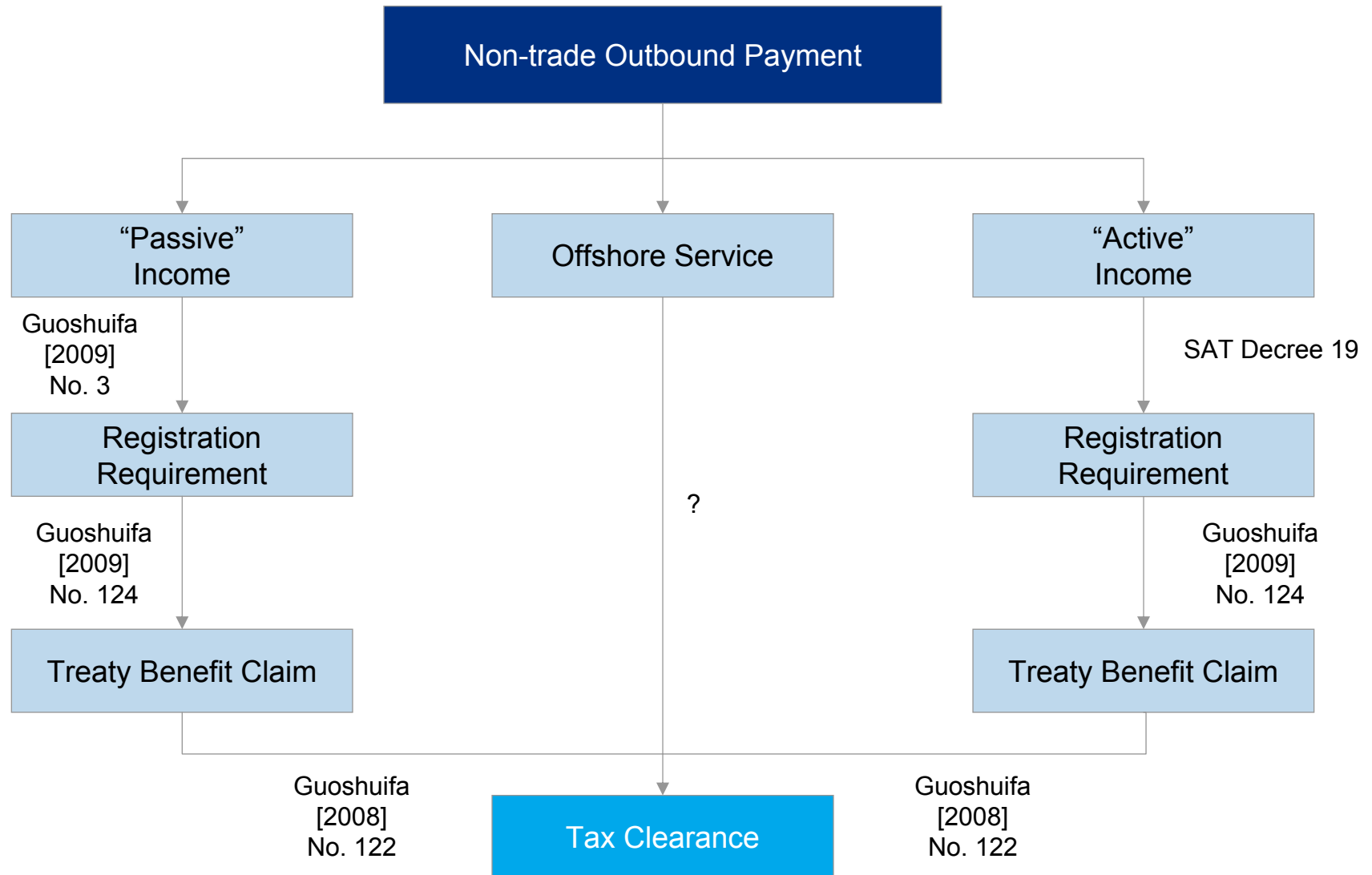
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Huifa [2004] No. 62

Administration of Non-trade Foreign Exchange Payment for Multinational Corporations (“MNCs”)

- Applicability
  - Qualified Multinational Corporations (Chinese-funded multinational corporations and foreign-invested multinational corporations) registered with State Administration of Foreign Exchange (“SAFE”) authorities
- Remittable non-trade payments by qualified MNC
  - Advanced or apportioned expenses
  - Salaries, benefits and allowances of the employees of foreign nationality
  - Overseas commercial insurance premiums of foreign employees
  - Overseas business trips expenses and overseas training fees
  - Expenses such as the R&D expenses, procurement expenses and marketing expenses
  - Other advanced or apportioned expenses

# Tax Clearance Procedures

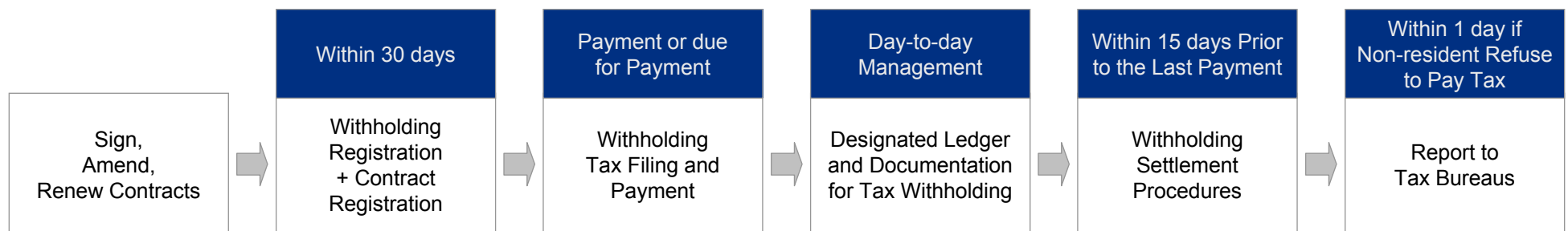
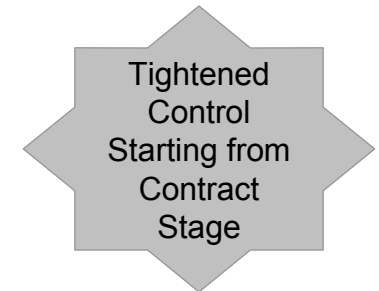


# Tax Clearance Procedures—Registration Requirement for “Passive” Income

Guoshuifa [2009] No. 3

Provisional Measures for the Administration of EIT Withholding for Non-resident Enterprises

- “Passive” income
  - Dividend, Interest, Rental, Royalty
  - Gains from property transfer
  - Other gains
- Impacts
  - Introduced a new contract filing and withholding registration requirement for the withholding agent
  - Confirmed that withholding obligations start at the time the relevant payment is made or due to be made
  - New reporting requirements for Chinese companies on offshore share transfers by overseas shareholders
- Withholding agent’s responsibilities

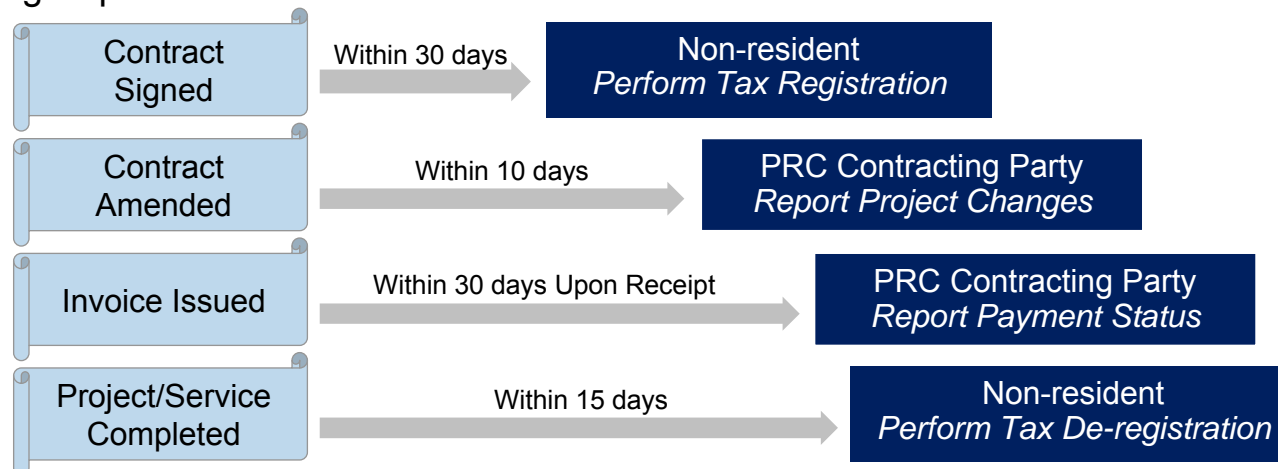


# Tax Clearance Procedures—Registration Requirement for “Active” Income

## SAT Decree 19

### Provisional Measures on Tax Administration on Contract Projects and Service Provisions for Non-residents

- “Active” income
  - “Project income”—construction, installation, assembly, decoration, exploitation, other engineering projects, etc.
  - “Service income”—includes income from processing, repair and maintenance, transportation, warehousing, consulting and agency, design, technical service, education and training and other labor services, etc.
- Impacts
  - Introduced project filing and withholding registration requirements
  - Introduced project status and payment status reporting requirements
- Registration and filing requirements



# Tax Clearance Procedures—Registration Requirement for “Active” Income (Cont’d)


SAT Decree 19

Provisional Measures on Tax Administration on Contract Projects and Service Provisions for Non-residents

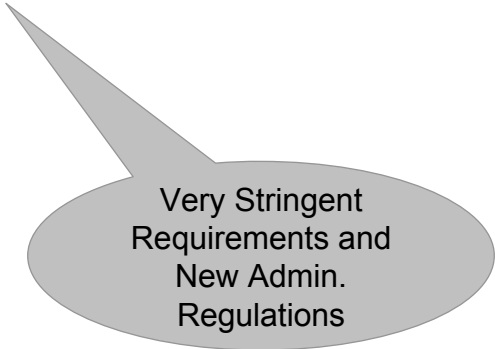
- Tax filings
  - PE Constituted
    - Quarterly provisional filing + Annual filing + Annual settlement and clearance
  - No PE
    - Nil filing + submit the Application Form to enjoy the tax treaty treatments + submit Residency Proof and other documents



Need Financial Report



Need to Report Details of All Expatriates' Name, Travel Itinerary, Salary, Payment Method, Service Rendered



Very Stringent Requirements and New Admin. Regulations

# Tax Clearance Procedures—Treaty Benefit Claim

Guoshuifa [2009] No. 124

Administrative Measure on Tax Treaty Treatments Enjoyed by Non-residents (Provisional)

Item	Approval Requirement	Filing Requirement
Applicability	<ul style="list-style-type: none"> <li>• Dividends</li> <li>• Interest</li> <li>• Royalties</li> <li>• Capital gains</li> </ul>	<ul style="list-style-type: none"> <li>• Permanent establishments and business profits</li> <li>• dependent personal services</li> <li>• independent personal services</li> <li>• other tax treaty relief (except for claims subject to the approval requirements)</li> </ul>
Procedure	<ul style="list-style-type: none"> <li>• Application form</li> <li>• Identity information report</li> <li>• A certificate of tax residence of home country</li> <li>• Relevant supporting documents, e.g. property right certificate, contract or agreement, payment voucher, etc; and</li> <li>• Other relevant documentation requested by the tax authorities</li> </ul>	<ul style="list-style-type: none"> <li>• Report form</li> <li>• A certificate of tax residence of home country; and</li> <li>• Other relevant documentation requested by the tax authorities</li> </ul>

### 3. Practical Challenges and Good Practice

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# Dividends

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- Challenges in applying for treaty benefit
  - Tax resident certificate
  - Beneficiary ownership test: Guoshuihan [2009] No. 601. An agent or conduit company will not be regarded as a beneficial owner (and, therefore, will not qualify for treaty benefits)
  - Specific factors for determining the beneficial owner
    - The applicant is obliged to distribute most of its income (e.g. more than 60%) to a resident of third country within a prescribed time period (e.g. within 12 months from the date of receipt)
    - The applicant has no or minimal business activities
    - The applicant's assets, scale of operations and personnel deployment are not commensurate with its income
    - The applicant has no or minimal control and decision-making rights and does not bear any risks
    - The income of the applicant is non-taxable or, if subject to tax, is subject to a low effective tax rate
- Good practice
  - Maintain proper business substance at the recipient company level before the claim
  - Obtain tax resident certification on a timely basis

## Dividends (Cont'd)

- Some local practice for treaty benefit claim

Location	Tax Residence Certificate	Beneficiary Ownership Test
Jiangsu	Not required for HK entity	Exemption under certain special circumstances
Shanghai	Not required in certain districts for HK entity	Unclear
Zhuhai, Guangdong	Treaty benefits might be tentatively granted first followed by examination at tax authority's discretion	
Zhejiang	Not required in certain cities for HK entity	Unclear
Other Locations	Any special local practice?	Any special local interpretation or guidance?

# Royalties

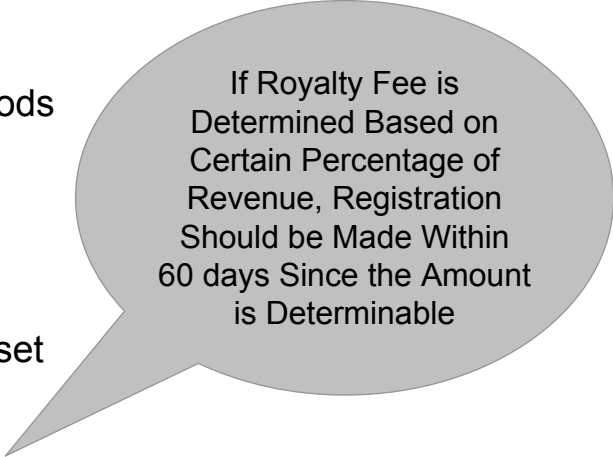
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- Challenges

- Characterization of royalty income—Guoshuihan [2009] No. 507
  - Information concerning industrial, commercial or scientific experience
  - Service contracts
  - Technical assistance
  - Payments specifically not considered as royalty payments
- Import Custom Duty and VAT if viewed as part of payment for imported goods
- Royalty rate exceeding the percentage limit
- Where treaty benefit is sought, similar challenge as dividend above

- Good practice

- Planning/documentation study on the fairness of the charge rate at the outset
- Proper rate split between technology and trademark
- Timely registration with the local ministry of commerce authority
- Timely registration with the local science and technology authority if BT exemption is sought
- Timely bill and payment
- Build royalties into sales price?



If Royalty Fee is Determined Based on Certain Percentage of Revenue, Registration Should be Made Within 60 days Since the Amount is Determinable

# Loan/Interests

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- Challenges
  - Purpose of loan
  - Borrowing capacity limitation—regulatory requirement for foreign investors
  - Thin capitalization rule—Caishui [2008] No.121
    - Debt-to-equity ratios: 5:1 for financial institutions and 2:1 in all other cases
    - Interest expense exceeding the stipulated threshold is non-deductible unless the loan is arm's length
    - Higher burden to prove arm's length if exceeding the ratio
  - Where treaty benefit is sought, similar challenge as dividend above
- Good practice
  - Analysis of a company's relevant debt/equity ratio if it is larger than 5 or 2
  - Planning (roughly at least) and/or documentation study to ensure the rate's fairness
  - Timely repayment of interest and principal

# Intercompany Service

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- Challenges
  - Actual occurrence of service
  - Reasonableness of charges
  - Disallowed deduction and remittance as management fee
  - Deemed as taxable income although service is actually performed outside China
  - Offshore technology service treated as royalty?
- Good practice
  - Draft the agreement properly
  - Use payment terms preferred by the tax authority wherever possible
  - Maintain good documentation to show the actual occurrence of the service and the place of provision of service
  - Planning and/or documentation study to justify the fairness of service charges
  - Make payment timely
  - Cost sharing as appropriate, e.g. services are between European entities and their Chinese related parties
  - Distinguish it from management fee

# Intercompany Service (Cont'd)

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## Good Sample

- ▲ Detail service scope as specifically as possible
- ▲ Avoid using word “management fee”
- ▲ Separate different service items in different contracts
- ▲ Service fee charged on hourly rate basis may be accepted more easily
- ▲ Timely communication with tax authority and preparation of supporting documents
- ▲ Competent tax specialist who has clear understanding of transaction and is able to respond correctly
- ▲ Careful review application packages before submission

## Bad Sample

- ▼ Framework service contract and charge on cost allocation basis, which are likely to be challenged as management fee
- ▼ Use word “management” in the scope
- ▼ Weakness in maintenance of supporting documents in a timely manner
- ▼ Lack of communication with tax authority on certain ambiguity areas
- ▼ Improper understanding of tax rule and other regulations
- ▼ Don't have solid understanding of transaction substance

# Expatriate Remuneration Recharge

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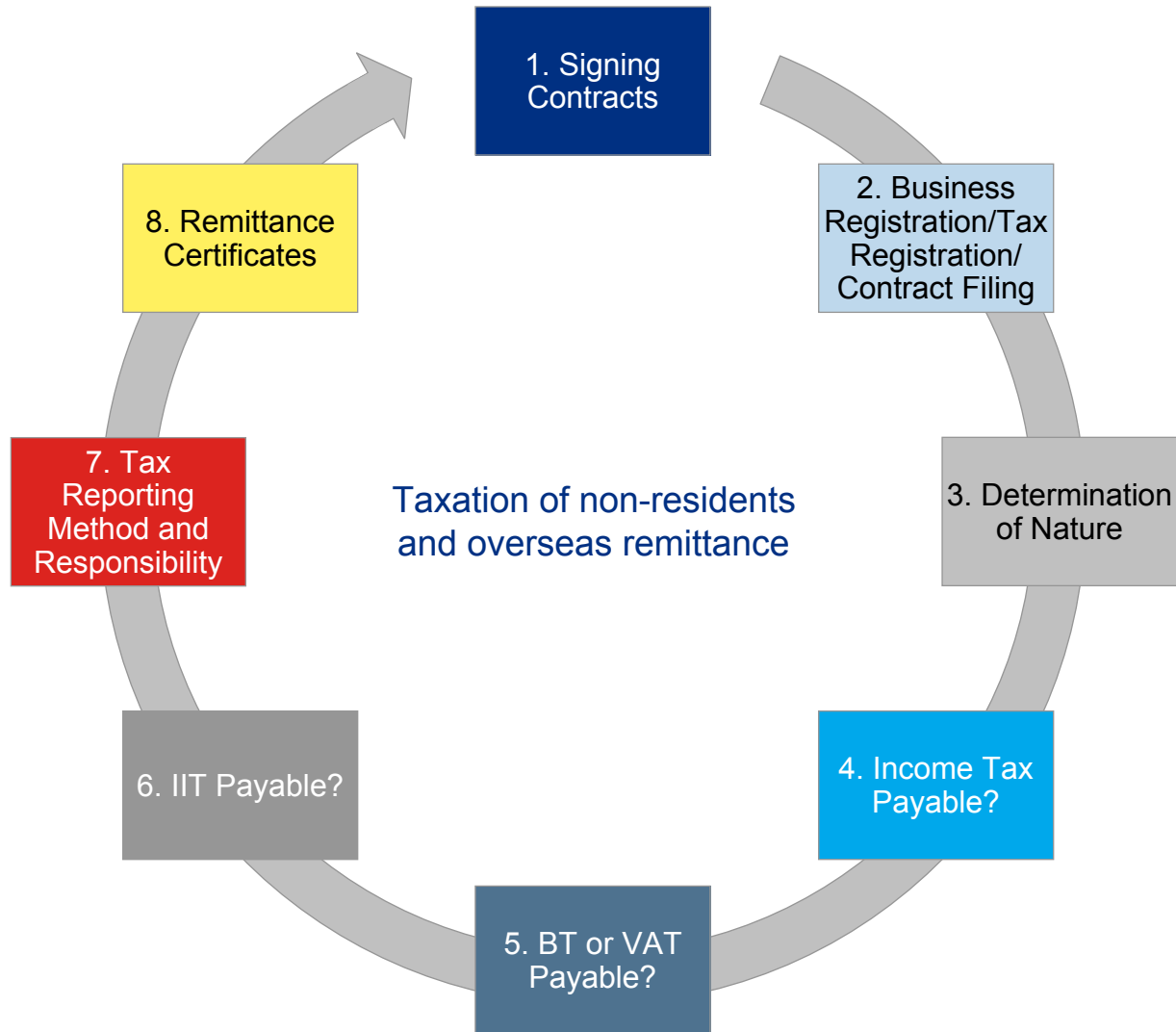
- Challenges
  - Unable to receive tax clearance certificate unless tax is paid
  - Denial of remittance by SAFE because not in the permitted scope unless qualified MNC
- Good practice
  - Qualify as registered MNC with SAFE
  - Pay on a timely manner
  - Permissibility under the new Circular 75
  - Manage PE exposure as a result of international secondment arrangement

## 4. Summary

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# Summary

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## 5. Questions and Answers

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